Syarikat Persaudaraan Sdn Bhd v Ketua Pengarah Jabatan Hasil Dalam Negeri

HIGH COURT (KOTA KINABALU) — TAX APPEAL NO K02 OF 1995
IAN CHIN J
17 FEBRUARY 1996

Revenue Law *— Income tax — Case stated — When decision of Special Commisioners reviewable by High Court — Income Tax Act 1967 Sch 5 paras 34 & 35*

Revenue Law *— Income tax — Deduction — Whether timber concession is capital asset — Whether cost incurred in acquiring timber concession is deductible — Income Tax Act 1967 s 33(1)*

On 9 July 1979 Syarikat Persaudaraan Sdn Bhd ('the appellant') resolved to give the late Tun Fuad Stephens ('Tun Fuad') a death gratuity of RM1m for his contribution to the appellant which included obtaining a timber concession ('the special licence') for the appellant. The Special Commissioners of Income Tax ('the Special Commissioners'), in deciding that the death gratuity was not an allowable deduction, concluded that the gratuity was a guise to evade tax and that the appellant had failed to prove that the gratuity was an expenditure wholly and exclusively incurred in the production of gross income within the meaning of s 33(1) of the Income Tax Act 1967 ('the Act'). This is the appellant's appeal by way of case stated under paras 34 and 35 of Sch 5 to the Act against the Special Commissioners' decision. The issues before the court were: (a) whether the facts and inferences therefrom warranted the Special Commissioners' conclusion that the gratuity was a guise to evade tax; and (b) whether the timber concession was a capital asset.

Held, dismissing the appeal:

(1) Paragraph 34 of Sch 5 to the Act provides that here can only be an appeal on a question of law (see p 616H). The term 'question of law' includes the inferring of a conclusion from the primary facts where the process of inference involves assumptions of the legal effect or consequences of the primary facts (see p 617D; *NYF Realty Sdn Bhd v Comptroller of Inland Revenue* [1974] 1 MLJ 182 at p 183 and *Director-General of Inland Revenue v Rakyat Berjaya Sdn Bhd* [1984] 1 MLJ 248 at p 252 followed).

(2) On the facts there was ample justification for the inferences drawn by the Special Commisioners that the gratuity was a guise to evade tax, that the gratuity was an afterthought and that the gratuity was not made for the purpose of rewarding Tun Fuad for his contribution to the appellant (see p 617F–618D).

(3) Since the right conferred by the special licence did not by itself bring any income, this asset could not be described as an income. Therefore, the right conferred by the special licence, not being an income but an asset, had to be capital which the appellant had acquired. Assuming that the death gratuity was paid for the

purpose of acquiring the special licence, it was paid for the purpose of acquiring capital, for which no deduction was allowed, and was not incurred wholly and exclusively for the purpose of producing the gross income of the appellant (see p 622B–D; *Pitt (Inspector of Taxes) v Castle Hill Warehousing Co Ltd* [1974] 3 All ER 146 and *Inland Revenue Commissioners v Mallaby-Deeley* [1938] 4 All ER 818 followed).

[Bahasa Malaysia summary

Pada 9 Julai 1979 Syarikat Persaudaraan Sdn Bhd ('perayu') telah membuat ketetapan untuk memberi mendiang Tun Fuad Stephens ('Tun Fuad') suatu ganjaran kematian sebanyak RM1 juta untuk sumbangannya kepada perayu termasuk mendapatkan konsesi kayu balak ('lesen khas') untuk perayu. Pesuruhjaya Khas Cukai Pendapatan ('Pesuruhjaya Khas'), dalam memutuskan bahawa ganjaran kematian itu bukanlah suatu potongan yang boleh dibenarkan, menyimpulkan bahawa ganjaran itu adalah samaran untuk mengelak cukai dan bahawa perayu telah gagal untuk membuktikan bahawa ganjaran itu adalah suatu perbelanjaan yang ditanggung sepenuhnya dan secara eksklusif untuk menghasilkan pendapatan kasar dalam makna s 33(1) Akta Cukai Pendapatan 1967 ('Akta itu'). Ini adalah rayuan perayu melalui kes yang dinyatakan di bawah perenggan 34 dan 35 Jadual 5 kepada Akta itu terhadap keputusan Pesuruhjaya Khas. Isu-isu di hadapan mahkamah adalah: (a) sama ada fakta-fakta dan inferens daripadanya mewajarkan keputusan Pesuruhjaya Khas bahawa ganjaran itu adalah samaran untuk mengelak cukai; dan (b) sama ada konsesi kayu balak itu adalah suatu aset permodalan.

Diputuskan, menolak rayuan:

(1) Perenggan 34 Jadual 5 kepada Akta itu memperuntukkan bahawa hanya boleh terdapat rayuan terhadap soal undang-undang (lihat ms 616H). Terma 'soalan undang-undang' termasuk membuat penyimpulan menerusi inferens daripada fakta-fakta utama di mana proses inferens melibatkan andaian kesan atau akibat undang-undang mengenai fakta-fakta utama (lihat ms 617D; *NYF Realty Sdn Bhd v Comptroller of Inland Revenue* [1974] 1 MLJ 182 di ms 183 dan *Director-General of Inland Revenue v Rakyat Berjaya Sdn Bhd* [1984] 1 MLJ 248 diikut).

(2) Di atas fakta-fakta terdapat justifikasi yang lebih daripada cukup untuk inferens yang diperolehi oleh Pesuruhjaya Khas bahawa ganjaran itu adalah suatu samaran untuk mengelak cukai, bahawa ganjaran itu telah merupakan sesuatu yang difikirkan kemudian dan bahawa ganjaran itu telah tidak dibuat untuk tujuan memberi ganjaran kepada Tun Fuad untuk sumbangannya kepada perayu (lihat ms 617F–618D).

(3) Oleh kerana hak yang diberi oleh lesen khas itu tidak secara sendirinya mendatangkan apa-apa pendapatan, aset ini tidak boleh digambarkan sebagai satu pendapatan. Oleh yang demikian,

A hak yang diberi oleh lesen khas itu, yang bukannya suatu pendapatan tetapi adalah suatu aset, semestinya adalah permodalan yang telah diperolehi oleh perayu. Membuat anggapan bahawa ganjaran kematian itu telah dibayar untuk tujuan memperolehi lesen khas, ianya telah dibayar untuk tujuan memperolehi permodalan yang untuknya potongan tidak dibenarkan dan telah tidak ditanggung keseluruhannya dan secara eksklusif untuk tujuan menghasilkan pendapatan kasar perayu (lihat ms 622B–D; *Pitt (Inspector of Taxes) v Castle Hill Warehousing Co Ltd* [1974] 3 All ER 146 dan *Inland Revenue Commissioners v Mallaby-Deeley* [1938] 4 All ER 818 diikut).]

Notes

For cases on appeal by way of case stated see 10 *Mallal's Digest* (4th Ed, 1996 Reissue) paras 1761–1764.

For cases on deductible expenditure see 10 *Mallal's Digest* (4th Ed, 1996 Reissue) paras 1796–1822.

Cases referred to

Director-General of Inland Revenue v Rakyat Berjaya Sdn Bhd [1984] 1 MLJ 248

Inland Revenue Commisioners v Mallaby-Deeley [1938] 4 All ER 818

Lower Perak Co-operative Housing Society Bhd v Ketua Pengarah Hasil Dalam Negeri [1994] 2 MLJ 713

NYF Realty Sdn Bhd v Comptroller of Inland Revenue [1974] 1 MLJ 182

Pitt (Inspector of Taxes) v Castle Hill Warehousing Co Ltd [1974] 3 All ER 146

Vallambrosa Rubber Co Ltd v Farmer (1910) 5 Tax Cas 529

Legislation referred to

Income Tax Act 1967 s 33(1), Sch 5 paras 34, 35

Wong Suk Anne and *June Tan* (*Skinner Lind Willie Wong & Chin*) for the appellant.

Kok Keng Fai and *Abdul Karim bin Abdul Jalil* (Senior Federal Counsel) for the respondent.

Cur Adv Vult

Ian Chin J:

INTRODUCTION

I This case was stated by the Special Commissioners of Income Tax pursuant to paras 34 and 35 of Sch 5 to the Income Tax Act 1967 ('the Act'), regarding their decision that Syarikat Persaudaraan Sdn Bhd ('the appellant') had failed to prove that a sum of RM1m, which the appellant had resolved to pay to the children of the late Tun Fuad Stephens ('Tun Fuad') as a death gratuity, is an expenditure wholly and exclusively incurred in the

production of gross income within the meaning of s 33(1) of the Act. The Special Commissioners are of the opinion that the said death gratuity is not an allowable deduction. I will next set out the agreed facts.

FACTS OF CASE

The appellant was incorporated on 26 November 1971. There was no provision in its memorandum and articles of association for the payment of death gratuity or terminal benefit to any director or employee. The shareholdings of the appellant were as follows:

(1) Tun Fuad — 550 shares
(2) Toh Puan Rahimah Stephens — 250 shares
(3) Tan Sri Benedict Stephens — 125 shares
(4) Dato Lim Hong Ghee — 75 shares

Tun Fuad was the founding director and the two personages (2) and (3) are his family members, being respectively his wife and his brother. Tun Fuad was the chairman and director from 1972 until 16 April 1976, when he resigned to become the Chief Minister of Sabah. During his term as chairman and director he was paid salaries and fees of RM9,000 in 1972, RM130,000 in 1973, RM24,000 in 1974, RM24,000 in 1975 and RM10,000 in 1976. The appellant's pre-tax profits for the relevant years were as follows:

1973	RM3.1m
1974	(Loss of RM28,000)
1975	RM75,000
1976	RM3,790,430
1977	RM1,779,800
1978	RM395,440
1979	RM261,146

The appellant was on 30 July 1971, issued with a licence to extract timber covering an area of approximately 100 sq miles in Lumerau Forest Reserve, in the District of Sandakan South. Tun Fuad and Toh Puan Rahimah Stephens were also, as at 23 February 1967, subscribers of Syarikat Donsons Sdn Bhd ('Donsons Company') and it was to Donsons Company that Tun Fuad and Toh Puan Rahimah Stephens on 29 August 1973, sold their shares in the appellant. Notwithstanding the divesting of his shareholding Tun Fuad, as was stated earlier, continued as the chairman and director of the appellant and continued to receive salaries and fees until 16 April 1976. Tun Fuad also received remuneration from Donsons Company though he did not perform any executive function in that company. Tuan Fuad's illustrious career included being the Malaysian High Commissioner to Australia from the year 1968 to 1973 and, as mentioned earlier, the Chief Minister of Sabah from 16 April 1976 until his death in a plane crash on 6 June 1976. Tun Fuad was, a fact not averred to by any party but which the court can take judicial notice of, the Head of State of Sabah from 1973 to 1975. At the time of his death Tun Fuad had four children schooling in

A Australia and they wrote to the appellant to consider making a death gratuity to them in view of the great contribution made by Tun Fuad to the appellant. It was on 9 July 1979, more than three years after the death of Tun Fuad, that the appellant resolved to give the late Tun Fuad the death gratuity of RM1m of which on RM63,000 was shown in the accounts to have been paid to his wife Toh Puan Rahimah Stephens, while the balance B remains unpaid. At the time of the resolution, the appellant still had 21,000 acres of the land to extract timber from. By this time Toh Puan Rahimah Stephens was already a state minister and was drawing director's fees from the appellant and from Donsons Company. As for Tun Fuad's contribution to the appellant, which was the supposed reason for the death gratuity, this C was described in the following manner:

(i) applied for the timber concession;
(ii) obtained the necessary approval;
(iii) obtained the timber area;
D (iv) obtained the timber licence;
(v) obtained the timber export licence;
(vi) obtained TOLs for roads, dumping points and log ponds;
(vii) selected the suitable contractor;
(viii) negotiated favourable terms and conditions for timber E extraction contractor;
(ix) selected a suitable timber buyer;
(x) negotiated favourable terms and conditions for timber sale;
(xi) negotiated and obtained licence;
F (xii) obtained co-operation of contractor to vary production in line with the market demands;
(xiii) ensured smooth operation and profit

For the year of assessment 1979, the appellant was assessed to pay taxes totalling RM640,352.24. The case here only concerns the issue of the death G gratuity of RM1m. The respondent had cross-appealed against certain orders of the Special Commissioners which, by consent, is allowed. More of the facts will be referred to when the grounds of appeal are considered.

GROUNDS OF APPEAL

H *Whether death gratuity a disguise*

The conclusion of the Special Commissioners that the death gratuity was a guise to evade tax came under criticism by Ms Wong Suk Anne, learned counsel for the appellant, who submitted that the evidence does not warrant such a conclusion. The facts, and the inferences drawn therefrom, that the I Special Commissioners relied on for their conclusion, including their reasoning can be summarized as follows:

(1) The payment of the death gratuity was only brought up in 1979, and not in 1976 or 1977 or 1978 which belies its true purpose since a death gratuity presupposes spontaneity and a decision three years after the death of Tun Fuad could not be spontaneous;

(2) The question of the payment of the death gratuity was not brought up during the years of 1975, 1976 and 1977 when the appellant was making pre-tax profits of RM75,000, RM3,790,430 and RM1,797,800 respectively, and was therefore best able to make the payment but was brought up later at a time when the appellant was only making RM395,440 in 1978 and RM261,146 in 1979 and therefore could hardly afford such a payment; A B

(3) The unusual and irregular manner in which the amount of the death gratuity was posted in the 1978 accounts when the resolution approving the same was only made later on 9 July 1979;

(4) There was no legal obligation to pay the death gratuity and neither was there any provision in the memorandum and articles of association of the appellant; C

(5) Tun Fuad was already very substantially awarded by the state government of Sabah by being given further timber concessions and was paid substantial director fees to the amount of RM197,000 by the appellant; D

(6) Tun Fuad was not actively involved in the day to day running of the appellant because at the crucial time he was Malaysia's High Commissioner to Australia from 1968 to 1973 and the management was left effectively to one Lim Hong Ghee who had on behalf of the appellant executed the timber extraction agreement on 3 February 1972, with Lian Hing Construction & Engineering Sdn Bhd and the timber sale agreement with Tung Yuen Trading Company of Hongkong on 13 March 1972; on both dates Tun Fuad was in Australia as the Malaysian High Commissioner, and the appellant had left the management of the appellant to Donsons Company under an agreement made on 1 July 1973; and E F

(7) Tun Fuad's effective control of the appellant through Donsons Company, of which he was also the controlling shareholder, allowed him to be paid a director's fee even though he was no longer a shareholder of the appellant after the sale of his shares to Donsons Company and thus there was no necessity to pay him a death gratuity. G

Before considering whether the Special Commissioners were correct in their conclusion, some relevant statutory provisions and principles of law must be borne in mind. There can only be an appeal on a question of law (see para 34, Sch 5 to the Act). As for what is a question of law and what is a question of fact, this is how it is stated in the case of *NYF Realty Sdn Bhd v Comptroller of Inland Revenue* [1974] 1 MLJ 182 at p 183: H

> The test to be applied in distinguishing questions of fact from questions of law is indeed a matter of great difficulty. Lord Parker in the case of *Farmer v Cotton's Trustees* [1915] AC 922 suggested the following test. He said:
>
> > '... where *all* the *material facts* are *fully found* and the *only question* is whether the facts are such as to bring the case within the provisions properly construed of some statutory enactment, the question is one of law only.'(Italics supplied.) I
>
> A question that depends for its answer on matters of degree, on what weight is to be given to this and that variable factor, like factors of duration,

A repetition, scale of operations, is ordinarily answerable only for the particular case and is therefore a question of fact. Whether or not facts and evidence produced before the Special Commissioners lead to the conclusion that the taxpayer was or was not carrying on the business or trade within the meaning of the law depends on inference from facts. The inference to be drawn from the acts and conduct of the taxpayer, ie whether he carried on a trade or B business is, in my view, a question of law. The inference drawn by the Special Commissioners that a particular taxpayer was carrying on a business or trade cannot bind the court, as such an inference can only be derived from other primary facts ...

Another case which touches on this point is *Director-General of Inland* C *Revenue v Rakyat Berjaya Sdn Bhd* [1984] 1 MLJ 248 at p 252, where it was said:

> Appeals from the decisions of the Special Commissioners in tax cases are made by way of case stated under the Income Tax Act 1967 Sch 5, para 34. The paragraph states clearly that any appeal is on a question of law. Hence, pure findings of fact may not be challenged on an appeal. However, the court D has clear and undoubted jurisdiction to reverse a decision on questions of law. The term 'question of law' includes correctness of (a) pure statements of law (eg as to the correct interpretation of a statutory provision), and (b) the inferring of a conclusion from the primary facts (where the process of inference involves assumptions as to the legal effect or consequences of the primary facts).

E

(See also *Lower Perak Co-operative Housing Society Bhd v Ketua Pengarah Hasil Dalam Negeri* [1994] 2 MLJ 713 for the cases touching this point.) Returning now to the submission of Ms Wong that the evidence which I have earlier set out does not justify the conclusion that the death gratuity was a guise to evade tax, it has to be remarked that Ms Wong did not F elaborate on how the inference from the facts cannot be made. The decision to give the gratuity was not only not thought of when Tun Fuad was at the helm of the appellant, it was also not thought of when Tun Fuad left the appellant in 1976 when by this time the appellant had made a pre-tax profit, for the years from 1973 to 1976, of about RM6.9m. It was also not G thought of when Tun Fuad died on 6 June 1976 but only about two years afterwards when the appellant posted the amount of the death gratuity in the 1978 accounts for which year the pre-tax profit was only RM395,440. It was clearly, as concluded with ample justification by the Special Commissioners, an afterthought on the part of the appellant to give the death legacy. What then of the conclusion of the Special Commissioners H that the death gratuity was not actually for the purpose of rewarding Tun Fuad for what he had contributed to the appellant? Again, I am of the view that there is ample justification for that inference given the facts set out and relied on by the Special Commissioners. The two companies, the appellant and Donsons Company, as found by the Special Commissioners, were the I family companies of Tun Fuad and the payment of the death gratuity in the final analysis, and this can be perceived without lifting the corporate veil but by looking through the veil as it is glaringly clear, is actually taking from one pocket of Tun Fuad to put into the other but with the result, if the tax deduction claimed is allowed, that the recipients (Tun Fuad's children) do not have to pay tax while the appellant also saves on payment of tax by treating the payment of the death gratuity as an income expenditure. The

ground upon which the Special Commissioners' conclusion rested becomes even firmer when one takes into account the belated resolution to give the death gratuity, the fact that Tun Fuad could not have contributed to the running of the appellant at the time the appellant negotiated and entered into the agreement to extract and sell the timber since he was at the relevant time the Malaysian High Commissioner to Australia which belies the assertion that the death gratuity was for his contribution to the appellant. There is also the fact that he was already amply rewarded by the appellant in the form of substantial director's fees and being paid the same when he was no longer a shareholder, the fact that there was no legal obligation to pay and neither was there any provision in the memorandum and articles of association of the appellant to pay the same and the irregular manner in which the amount of the death gratuity was posted in the 1978 account of the appellant which all lend tremendous weight to the inference of the Special Commissioners that the death gratuity was not for the purpose of rewarding Tun Fuad for his contribution to the appellant, even more so if one is to take into account that whatever benefits reaped by the appellant as a result of the contribution of Tun Fuad, Tun Fuad, being then the largest shareholder, would also be the eventual beneficiary. With that finding of the Special Commissioners which I uphold, it means this appeal can be dismissed without going into the other grounds. Nevertheless, in case there is a need to go into the merits of the other grounds of this appeal, I feel I should deal with them and what I am going to decide is on the assumption that the Special Commissioners and I are erroneous in concluding that the death gratuity is a guise and not a genuine death gratuity. The next issue is whether the timber concession was a capital asset.

Whether timber concession a capital asset

It is common ground that it was through the effort of Tun Fuad that the concession of 100 sq miles was by 20 July 1971, obtained for the appellant even before the appellant was incorporated, which date was 26 November 1971. The Special Licence to Take Forest Produce ('the special licence') issued to the name of the appellant was dated 19 August 1971, and it was only signed on behalf of the appellant on 22 December 1971. The special licence is in these terms:

STATE OF SABAH
FOREST RULES 1969
Special Licence to take Forest Produce
Issued under the Forests Enactment 1968
and Forests Rules 1969
Authority—MNRC 401/11/11/5 dated 30 July 1971
(FD 6509/164/6)

No SK 6/71	Forest Circle	Sandakan
	Forest District	Sandakan South

1. This licence authorises Sharikat Persaudaraan Sdn Bhd Kota Kinabalu (hereinafter referred to as 'the licensee') to take timber within the area delineated on the plan annexed hereto subject to the attached conditions and to the provisions of the Forests Enactment 1968 (Cap 169) and Forests Rules 1969. For all purposes this licence shall be deemed to have come into force on:

A

District: Sandakan) As delineated
Locality: Lumerau Forest Reserve) on the plan
Approximate area: 100 square miles) attached to
Date of issue: 30 July 1971) No FD 65/36A
Date of expiry: 31 December 1980

2. In this licence and in the conditions attached the expression:

B

(1) 'commercial species' means any tree of the genera as defined in Sch I having a girth of not less than 6 ft and 4 ft 6 inches above ground or clear of buttresses, whichever is the higher, and not being a prohibited species;

(2) 'defects' means natural blemishes as defined by Sch II occurring in timber;

C

(3) 'merchantable timber' means merchantable timber as defined by Sch III;

(4) 'Minister' means the appropriate State Minister;

(5) 'prohibited species' means any trees of the genera as defined in Sch IV;

(6) 'Forests Rules' means the Forests Rules 1969 or any Rules from time to time replacing the same;

D

(7) 'Conservator' means the Conservator of Forests or any Forest Officer authorised by the Conservator to exercise all or any of the powers conferred on the Conservator by this licence;

(8) 'Sawmill' means any machine or collection of machines used for the mechanical processing of timber in any form, and includes any veneer, plywood or other mill, but excludes power-operated chain-saws used for cross-cutting timber and wood-working machinery used for processing sawn timber.

E

Dated 19 August 1971

[Signed]
Conservator of Forests
(Pemelihara Hutan)

F

Countersigned as to Condition 7

[Signed]
Permanent Secretary to
the Minister
(Setia Usaha, Hasil Bumi
Jabatan Ketua Menteri)

G

We, Benedict Stephens & Lim Hong Ghee acting for and on behalf of the licensee, hereby agree to abide by the terms and conditions specified in this licence.

H

[Signed]

Signed at Kota Kinabalu this 22 December 1971 in the presence of:

Name and occupation of witness: Frederic Tan, Manager, Nabahu Company Sdn Bhd.

I

By virtue of the special licence the appellant can extract and sell timber from approximately 100 square miles of land. In relation to this right to extract and sell timber from approximately 100 square miles of land the Special Commissioners concluded that the contribution of Tun Fuad 'was not wholly and exclusively for the purpose of producing the gross income of the company, in fact, the sum total of his contribution pointed [to] the

acquisition of the capital of the company.' This decision was arrived at after the Special Commissioners had taken the view that the right, which they described as the forest concession, was an asset of enduring qualities and not merely something ephemeral and, after citing *Pitt (Inspector of Taxes) v Castle Hill Warehousing Co Ltd* [1974] 3 All ER 146 where it was said, at p 152:

> It seems to me that these authorities establish that in determining whether expenditure is incurred on revenue account or on capital account, one must consider at least three elements. First, what is the nature of the payment? Is there a single non-recurrent lump sum, paid once-for-all, on the one hand, or are there to be current payments, made, for example, for periods commensurate with those payments? Second, what is to be obtained by the payment? Is it some asset with lasting or enduring qualities, or is it merely ephemeral, or, indeed, something which cannot be described as an asset, whether tangible or intangible? Third, in what manner, is what is obtained to be used, relied on or enjoyed? Will it have a quality of recurrence which will point to an income nature, as by providing a flow of orders for goods, or will it bear a static aspect which points to a capital nature?

they concluded that:

> ... the timber concession was obtained through the good offices of the late Tun, an area of 100 square miles in [Lumerau] Forest Reserve in the District of Sandakan. By itself the [Lumerau] Forest will not yield any income. The timber has to be felled, graded and sold to [an] ascertained market. So what is this forest concession? Is it an asset with lasting or enduring qualities or something merely [ephemeral] or which could not be described on an asset, tangible or intangible? We think the forest concession is an asset with all the qualities as afore described and not just something [ephemeral].

This conclusion was attacked by Ms Wong in the following terms:

> It is a known fact in the timber trade that a timber concession is only a conditional right to extract timber from land which still belongs to the State Government. Such right is conditional on the concessionaire obtaining from the authorities a coupe area within which timber can be extracted (to be renewed annually), a licence to extract such timber and another licence to export (revocable by the State) [and] payment of royalties for the logs.
>
> For the reasons aforesaid, [the] appellant submits that the timber concession is a current asset which requires to be worked or developed (ending with the extraction of timber and sale of logs) to produce income for the company. The receipts from [the] sale of the logs extracted from the concession would be treated as revenue. And all initial expenses incurred in acquiring the concession would be revenue expenses and [would be] deductible for tax purposes.
>
> Therefore [I] submit that [the] contribution by the late Tun Fuad to acquire the timber concession [was] not for the purpose of acquiring a capital asset.
>
> [I] submit [that] though the payment is a once and for all payment and therefore suggesting that the payment is of a capital nature, this does not preclude the payment, on the particular facts of our case, from being a revenue expenditure for the purpose of the appellant's trade. See *Vallambrosa Rubber Company Ltd v Farmer* (1910) 5 Tax Cas 529 per Lord Dunedin.

The question, therefore, is whether the right granted by the special licence

A to the appellant is a capital asset. This issue proceeded on the assumption that the RM1m death gratuity was to pay Tun Fuad for getting the special licence for the appellant. If what Tun Fuad procured for the appellant, that is the special licence, is a capital asset then the sum of RM1m for payment of the death gratuity to Tun Fuad or his children is not outgoings and expenses wholly and exclusively incurred during that period by the appellant B in the production of gross income, within the meaning of s 33(1) of the Income Tax Act 1967, because what was produced was not a gross income but a capital.

The first of the questions that require an answer is what is capital? Given the infinite varieties of trade, it is just not possible to provide a C global definition for economics capital. The distinction between payments of an income nature and payments of a capital nature was said to be, sometimes a very fine and artificial one (see *Inland Revenue Commisioners v Mallaby-Deeley* [1938] 4 All ER 818 at p 823). What we have in this case is the special licence which confers upon the appellant a right to extract D and sell timber from 100 square miles delineated in a plan annexed to the special licence. The special licence is not transferable thus restricting the appellant to exploiting the timber by entering into extraction and sale agreements of the timber. In fact the special licence since 1976 can, in the public interests, be revoked (see s 24(7) of the Forests Enactment 1968). The special licence by itself does not generate any income but the right can E be exercised, through extraction and sale of the timber from the 100 square miles of land, so as to produce an income. But even without that exercise, the worth of the appellant because it possessed the special licence which holds tremendous potential for generating income, was, without doubt, considerably more than if it did not have the special licence. The F special licence was therefore an asset of the appellant, that much Ms Wong had agreed but this still begs the question whether the asset is a capital or an income. Ms Wong gave the example supra, of a housing developer who acquired the land and later sold parcels of the land after erecting houses thereon and she submitted that the land could not be treated as a capital and the receipts from the sale thereof could be treated as revenue and that G all expenses incurred in acquiring the land would be treated as revenue expenses. Therefore, submitted Ms Wong, the contribution of Tun Fuad in acquiring the special licence was not for the purpose of acquiring a capital asset, that is to say the special licence is not a capital asset. Ms Wong had referred to *Vallambrosa Rubber Co Ltd v Farmer* (1910) 5 Tax Cas 529 without stating how that case can be of assistance to her contention H and it seems to me that this case runs contrary to her contention that the acquisition of the land by a developer cannot be an acquisition of a capital asset because this is what was said in that case, at p 536, viz:

> It appears to me that, as at present worked, the trade, manufacture, adventure or concern of the company is the cultivation and production for sale at profit I of rubber and other tropical products. For this purpose land had to be acquired, cleared, and drained, roads made, and buildings erected, before the cultivation began. What was expended, for these purposes was I think capital expenditure, and not, in the sense of the Income Tax Act, money laid out and expended for the purposes of trade. But once the cultivation began with the

planting, expenditure on cultivation, production, and marketing was I think revenue expenditure for the purposes of the trade.

It seems to me from the passage I have just quoted that it cannot be true, as contended by Ms Wong in the example she gave, that land acquired for development into a housing estate is not capital. Anyway we are not dealing with land per se in our case but with a right to extract and sell timber from 100 square miles of land under a licence issued under the Forests Enactment 1968. Since, as pointed out earlier, the right conferred by the special licence does not by itself bring any income, this asset cannot be described as an income. Therefore, the right conferred by the special licence, not being an income but an asset, has to be a capital which the appellant had acquired. It is only after exercising the right under the special licence that an income can be produced. Thus, the Special Commissioners were correct in concluding that the special licence is a capital asset and therefore assuming that it was true that the death gratuity was to be paid to Tun Fuad for the purpose of acquiring the special licence, it was paid for the purpose of acquiring a capital for which no deduction is allowed and therefore it was not incurred wholly and exclusively for the purpose of producing the gross income of the company.

Given my conclusions I am of the view that the rest of the contentions do not fall to be considered. I therefore dismiss the appeal of the appellant. I also, in view of the concession of learned counsel for the appellant, allow the cross-appeal of the respondent and in doing so I order that the relevant corresponding paragraphs of the order should now read as follows:

(i) that the appellant has failed to prove that the RM1m resolved to be paid to the children of the late Tun Fuad Stephens as death gratuity is an expenditure wholly and exclusively incurred in the production of gross income pursuant to s 33(1) of the Income Tax Act 1967, and therefore the amount had been properly included in the notice of assessment dated 31 March 1979 for year of assessment 1979 and the notice of additional assessment dated 1 November 1980 for the year of assessment 1979;

(iii) the appeal against the notice of assessment for the year of assessment 1979 dated 31 March 1979 and against the notice of additional assessment for the year of assessment 1979 dated 1 November 1980 be dismissed and that the said notice of assessment and notice of additional assessment be and are hereby confirmed.

There will be costs to the respondent.

Appeal dismissed.

Reported by Ng Kian Pin